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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

NORTH CAROLINA ASSOCIATION OF
ELECTRONIC TAX FILERS, INC. AND
ROCKET REFUND, INC.,
Petitioners,

vs.

WILLIAM T. GRAHAM,
COMMISSIONER OF BANKS,
NORTH CAROLINA BANKING COMMISSION,
Respondent.

On Petition For A Writ of Certiorari To The
Supreme Court of North Carolina

REPLY MEMORANDUM FOR THE PETITIONERS

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I. THE DECISION OF THE SUPREME COURT OF NORTH CAROLINA CONFLICTS WITH DECISIONS OF THIS COURT CONCERNING PRE-EMPTION.

In its Brief in Opposition, Respondent argues to this Court that refund anticipation loans are private consumer loans that have nothing to do with the Internal Revenue Service's jurisdiction over taxation. This is not the case. Refund anticipation loans are solely a creation of the Internal Revenue Service. They do not exist outside the Internal Revenue Service's Electronic Filing Program.

Millions of Americans are presently participating in this program for the main reason of receiving their tax refunds within a few days of electronically filing their federal income tax returns. The entire Electronic Filing Program of the Internal Revenue Service, including the regulation of tax refund loans, was adopted in an effort to more quickly and efficiently aid the Internal Revenue Service in collecting taxes and providing refunds to taxpayers.

North Carolina's effort to intrude upon the field of federal income taxation through the North Carolina Refund Anticipation Loan Act is a clear violation of the Supremacy clause of the United States Constitution. The North Carolina Refund Anticipation Loan Act is in direct conflict with this Court's decisions in United States v. Snyder, 149 U.S. 210 (1893) and Lyeth v. Hoey, 305 U.S. 188 (1938). Congress has provided for uniformity in federal income tax policy, including refunds, and the states are prohibited from interfering with the federal income tax system. The issue here is whether federal tax refunds are in any way regulated by Congress. See Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947). The answer is clearly in the affirmative. Congress has left no room for the states to intrude in this area.

With regard to conflict pre-emption, this Court in Gade v. National Solid Wastes Management Ass'n, 112 S. Ct 2374 (1992), reaffirmed that state law cannot stand as an obstacle

to the accomplishment and execution of the full purposes of Congress. In order to make this determination, this Court is not to be guided by legislative labels and purported purposes. As stated in Hughes v. Oklahoma, 441 U.S. 332 (1979), "when considering the purpose of a challenged statute, this court is not bound by '[t]he name, description or the characterization given it by the legislature or the courts of the State,' but will determine for itself the practical impact of the law." Id. at 336 (quoting Lacoste v. Louisiana Dept. of Conservation, 263 U.S. 545, 550 (1926)).

This Court has traditionally applied a thorough, in-depth analysis of state statutes, the primary focus of which is to determine the effect of the statutes. The "effect rather than the purpose of a state statute governs pre-emption analysis," International Paper Co. v. Ouellette, 479 U.S. 481 (1987) (citing Perez v. Campbell, 402 U.S. 637 (1921). See also Healy v. Beer Institute, Inc., 109 S. Ct. 2491, 2499 (1989); and Wyoming v. Oklahoma, 112 S. Ct. 789, 801 (1992). In

Gade, this Court further stated: "[i]n assessing the impact of state law on a federal scheme, we have refused to rely solely on the legislature's professed purpose and have looked as well to the effects of the law. Gade at 2387.

Respondents would have the Court examine only the title and purported purpose of the North Carolina Refund Anticipation Loan Act, (hereinafter NCRALA). Such an analysis is not only simplistic, but also is contrary to the conflict preemption "effects" analysis which has been employed by this Court for decades, including a reaffirmation just two terms ago in Gade.

Petitioner's arguments are based upon the practical effects of the statute or as this Court in Gade stated: "the impact of the state law." The practical impact or effect of the NCRALA statute is to create not only obstacles, but impenetrable barriers to the "accomplishment and execution of the full purposes and objectives of Congress" as expressed by the Congress in the Internal Revenue Code and by the Internal

Revenue Service in its Regulations and Procedures:

> No person may individually or in conjunction or cooperation with another person process, receive or accept for delivery...a check in payment of refund anticipation loan proceeds without first being registered with the Commissioner.

N.C.G.S. section 53-247 (emphasis added).

In support of its proposition that the Act does not impinge upon federal taxation, the respondent bases its argument primarily on the affidavits of two local directors of the Service. However, the primary method for determining when a state statute "stands as an obstacle to the accomplishment and execution of the full purposes of Congress" is by determining the intent of Congress.

Using this Court's analysis to examine relevant statutory authority demonstrates how Congress has granted full authority to the Secretary of the Treasury to make federal tax refunds. Title 26 U.S.C. section 6402 (a) states:

> Authority to make credits or refunds. (a) General rule. In the case of any overpayment, the Secretary...on the part of the person who made the overpayment shall subject to subsections (c) and (d), refund any balance to such person.

Pursuant to the specific intent of Congress expressed in this statute, the Internal Revenue Service has promulgated regulations for the payment of refunds, including when individuals other than taxpayers can receive a taxpayer's refund.

Included in these regulations is a section specifically dealing with the endorsement, payment and deposit of United States Treasury checks. Also included in these regulations are the provisions for the deposit of Treasury checks in "financial institutions:"

The regulations state:

> A power of attorney is required by the Internal Revenue Service when the taxpayer wishes to authorize a recognized representative to perform one or more of the following acts on behalf of the taxpayer-

....

(5) Check drawn on the United States Treasury. The authority to receive (but not endorse or collect) a check drawn on the United States Treasury must be specifically granted in the power of attorney. (The endorsement and payment of a check drawn on the United States Treasury are governed by Treasury department circular No. 21, as amended, 31 CFR part 240. Endorsement and payment of such check by any person other than the payee must be made under one of the special powers of attorney prescribed by Circular No. 21, 31 CFR part 240.

26 CFR 601.504(a)(5)

The Code of Federal Regulations states:

PART 240 -- ENDORSEMENT AND PAYMENT OF CHECKS DRAWN ON THE UNITED STATES TREASURY

....

Section 240.11 Endorsement by payees

(a) General requirements. Checks shall be endorsed by the payees as set forth.

Thus, the endorsement and payment of the United States Treasury checks are solely and completely governed by the

regulations established by the Treasury department.

The primary purpose of the above cited sections is to allow financial institutions to receive taxpayer refunds directed to these institutions by the taxpayer through the system of Direct Deposit. The Internal Revenue Service specifically allows only those taxpayers who use electronic filing to file Form 8453, "U.S. Individual Income tax declaration for electronic filing," refund in any "financial institution" designated by the taxpayer. The regulations provide:

> (c) Checks endorsed by another on behalf of the named payee or payees--
>
> (1) Acceptable endorsement. The only acceptable endorsement of a check by another on behalf of a named payee or payees (except when a check is endorsed by a financial institution under the payee's or payee's authorization)
>
> ....
>
> (d) Endorsement of checks by a financial institution under the payee's authorization. When a check is credited by a financial institution to the payee's account under the payee's or payee's authorization, the

> financial institution may use [the following] endorsement.

31 CFR 240.11 (emphasis added).

Simply by filling out a form the taxpayer chooses which financial institution receives his deposit. When an electronic filer requests an RAL from a financial institution, that institution requires the taxpayer to file a Form 8453. This Form authorizes the institution making the RAL to accept the refund under 31 CFR 240.11. States are not authorized nor allowed to interfere with the issuance or deposit of Treasury Checks (i.e. refund checks). The regulations provide how the checks are deposited, 26 CFR 601.504(a)(5), how they are endorsed, 31 CFR 240, how the taxpayer must designate a financial institution, Form 8453, and most importantly, which "financial institution" is to receive the check, Form 8453.

There are no provisions for states to regulate the taxpayer choice of which financial institution will receive his or her refund. However, the NCRALA, by plain meaning

and strict construction, can and does regulate which institutions receive refunds and limits the taxpayer's federally designated choice.

The NCRALA states:

> **No person may...receive or accept for delivery...a check in payment of refund anticipation loan proceeds without first being registered with the Commissioner...**

N.C.G.S. section 53-247

This portion of the NCRALA places severe obstacles pertaining to the "accomplishment and execution of the full purposes of Congress." The act establishes barriers between the taxpayer and the choices which the Federal regulations and IRS Forms authorize. The NCRALA does this by allowing the state of North Carolina (the Banking Commissioner) to act as a gatekeeper. The act prevents a taxpayer designated institution from receiving refunds, which as the respondent admits are "in payment of refund anticipation proceeds." ("The loan proceeds will be the amount of the anticipated tax

refund, less fees and finance charges.") The loan is repaid when the actual tax refund is transmitted to the taxpayer's deposit account' at the lending bank. Failure to comply with the NCRALA can result in criminal penalties.

Respondent contends that the Act is protection against unfair trade practices. However, respondent overlooks the fact that the Internal Revenue Service requires a taxpreparer to charge a flat fee to assist a taxpayer in applying for an RAL. It must be the same for all taxpayers, and cannot be related to the amount of the refund or RAL. (Rev. Proc. 93-8, Sec. 10.04). The Internal Revenue Service has also set up detailed rules for suspending taxpreparers who violate the rules. (Rev. Proc. 93-8, Sec. 13). North Carolina cannot set up additional hurdles for tax preparers in the Electronic Filing Program when they have met the requirements of the Internal Revenue Service. See Rice v. Santa Fe Elevator Corp., supra. at 236.

II. THE NORTH CAROLINA REFUND ANTICIPATION LOAN ACT IS UNCONSTITUTIONAL UNDER THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION IN THAT THE EFFECT OF THE ACT IS TO CONTROL NATIONAL BANKING TRANSACTIONS BEYOND THE STATE'S BORDERS AND TO UNDERMINE UNIFORMITY OF REGULATION.

The respondent contends that the NCRALA does not apply to "financial institutions," because the NCRALA was drafted to exclude a person doing business as a "bank, savings association, or credit union...." The respondent fails to recognize the impact of the NCRALA on national banking transactions. Under the Treasury regulations which govern the deposit of refund checks, a financial institution is "any bank, savings bank, savings and loan association, Federal or State chartered credit union, or any other similar institution." 31 CFR part 240.2(f).

Moreover, these institutions cannot receive taxpayer's refunds as provided for by extensive Federal regulations, forms, and procedures of the IRS. Such a result is an

infringement on the comprehensive congressionally mandated system. Therefore, the effect of the NCRALA is to relegate and subvert a whole system of Treasury regulations, the system of Direct Deposit, and Internal Revenue Service tax forms, to nothing more than meaningless words unless the North Carolina Banking Commissioner gives his approval for these financial institutions to receive "a check in payment of a refund anticipation loan."

The respondent's analysis of this issue is cursory and superficial. The "effects" analysis sufficiently shows how the NCRALA places substantial barriers and obstacles on taxpayers, electronic filers and financial institutions, so that the "accomplishment and execution of the full purposes of Congress," as expressed in the United States Code and the Code of Federal regulations, cannot be realized.

Respondent attempts to base his lack of congressional intent on seventeen words, from a revenue procedure which consists of thousands of words, and hundreds of sentences.

From these statements, "[t]he Service has no involvement in RAL's" and "[t]his is a contract between the taxpayer and the lender," the respondent reaches his conclusion that: "[t]his statement is hardly a clear manifestation of federal intent to occupy the field of regulating the field of tax refund anticipation lending."

The respondent fails to comprehend the legislative intent set out in 26 U.S.C. 7805. The Secretary has acted in relation to refund anticipation loans. More importantly, the Secretary has not "expressly given" North Carolina any authority to subvert the carefully chosen and intricately designed system for the filing of electronic information, regulating who can file electronic information, or attempting to interfere with the system designed by the IRS to deposit taxpayers refunds into financial institutions of their own choosing.

The Revenue statement emphasized by the Respondent "[t]hat the Service has no involvement in RAL's," merely

states a truism of contract law, i.e. that the parties are free to bargain over contract terms. What the statement does not mean, is that the IRS will give up control of its systems and methods of revenue collection and refund payments. If the Respondent had set forth the entire Section, in context, dealing with RAL's, the intent of the Service to control the interrelationship of RAL's with the uniform system of dispersement and collection would be clear. The Internal Revenue Service does not make refund anticipation loans, but it regulates them. NCRALA forces electronic transmitters who assist taxpayers to submit to the Act or else be subject to criminal penalties.

The respondent contends that the petitioners do not have standing to raise the issue of the effect of the NCRALA on out-of-state national banks. This argument of standing was never raised below, and therefore, is not properly before this Court. The respondent in its Answer stipulated that the tax refund loans are all done by out-of-state national banks. No

North Carolina Banks are involved in this process.

Finally, the respondent ignores the exclusivity doctrine as it relates to the Commerce Clause. Respondent superficially states that federal taxation is not commerce. The respondent fails to comprehend that the entire process of the electronic filing of federal tax returns and refund loans is involved in interstate commerce. The national banks, the taxpreparers, and the taxpayers are all involved in a system which inextricably involves interstate commerce. The NCRALA undermines a federal tax system which was designed to be uniform, and to be a system exclusively controlled by the federal government.

CONCLUSION

The Writ of Certiorari should be granted because this case presents important and novel constitutional questions involving federal income tax and national banking policy. This case also presents compelling issues of national importance which effect millions of taxpayers.

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